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SUBJECT: IMF CONTENT WITH ZAMBIA DESPITE RISING INFLATION AND BUDGET DEFICIT

¶1. (U) Summary. A team from the International Monetary Fund (IMF) briefed diplomatic missions on its quarterly meetings with Zambian Government (GRZ) officials. The team's overall impressions of GRZ's macroeconomic performance were good; they noted continued GDP growth and national spending that remains approximately in line with government revenues. However, inflation figures have risen to double digits, public expenditures are rising in the wrong areas, and the need for more efficient public financial management and a Treasury Single Account persists. End Summary.

¶2. (U) The IMF evaluators forecast a real GDP growth in 2008 of 5.8 percent, slightly below 2007 growth of 6.3 percent, but they noted that these assessments were based on weak data quality. Higher production costs have dampened increased productivity. Year-on-year inflation in September was 14.2 percent, driven by high fuel and food prices. Although the IMF representatives projected a 12.7 annual inflation rate for CY 2008, they thought it likely that this could be contained to nine percent in 2009.

¶3. (U) The assessment team noted an increase in government expenditures composed primarily of higher salary payments (including housing allowances for government employees), an expanded fertilizer support (subsidy) program, power sector rehabilitation projects, interest payments on debt, and holding the unexpected presidential by-election. Reduced spending in other areas (international government travel, deferred fertilizer support payments, National Constitutional Conference fees, and capital investments) largely compensated for these increases, but unfinanced budget shortfalls will rise.

¶4. (U) IMF underscored to Charge subsequently that GRZ spending increases--although not large--are a cause for some concern, inasmuch as they represent a departure from previous years of relative fiscal discipline, and a shift toward discretionary government spending (i.e., short term political gains) instead of capital expenditures. The team speculated that the deficit will not require financing. Instead, the GRZ is likely to tap into committed--yet unliquidated--capital spending funds.

¶5. (U) Increased government spending on public sector salaries and fertilizer support will have long-term impact, however, as the GRZ is unlikely to reduce these in future budgets. The IMF mission noted continued problems in public financial management and pointed to the need for a Treasury Single Account. An IMF representative separately acknowledged USG assistance in this area and said that the Ministry of Finance had prepared a policy recommendation that is pending Cabinet's approval. He also said that technical assistance on debt-related issues was not a priority need at this time.

¶6. (U) The IMF evaluators commented on the need for improvements in tax administration and financial sector development to strengthen the money market. A draft debt management strategy has been submitted to Cabinet, as well as a strategy paper on energy to revise electricity rates, improve efficiency, and increase investment. GRZ capital spending remains inefficient. An estimated 400-500 billion kwacha (approximately USD 115-145 million) sits in government accounts awaiting release.

¶7. (U) According to the IMF evaluators, the GRZ had collected corporate tax and royalties from mining companies consistent with the new mining tax regime. They noted a shortfall, however, in the collection of windfall tax. They anticipated total mining revenues (minus windfall tax) in 2008 to be one trillion kwacha (USD 285 million) and 2009 to be 1.2 trillion kwacha (USD 345 million). On the Extractive Industries Transparency Initiative (EITI), they explained that the GRZ is submitting a plan in order to become an EITI candidate country, with an aim to becoming EITI compliant in ¶2010.

¶8. (SBU) Comment: IMF reps seemed alarmed at how quickly the GRZ abandoned fiscal discipline and gave way to populist electioneering economics in the short period since President Mwanawasa's hospitalization in July, although they downplayed the actual deficit increase. If the ruling Movement for Multiparty Democracy stays in power, it will be difficult to withdraw the largesse bestowed. However, the need to grant even more will decline dramatically after the election, regardless of who wins. We remain hopeful that the GRZ will then recognize once again the wisdom of capital investment.

KOPLOVSKY